



THE CITY OF SAN DIEGO
MANAGER'S REPORT

DATE ISSUED: August 4, 2004 REPORT NO. 04-180

ATTENTION: Honorable Mayor and City Council
Docket of August 9, 2004

SUBJECT: Transferring the Emerging Technologies Revolving Loan Fund, Phase II
("EmTek II") to a Private Nonprofit Financial Intermediary

REFERENCE: Manager's Report No. 99-87, dated April 21, 1999

SUMMARY

Issue – Should the City Council support the continued growth of the Emerging Technologies Revolving Loan Fund, Phase II ("EmTek II") by authorizing the City Manager to take actions, as described below, to facilitate the transfer of EmTek II to a Private Nonprofit Financial Intermediary?

Manager's Recommendation – Accept the City Manager's recommendation to support the continued growth of the Emerging Technologies Revolving Loan Fund, Phase II ("EmTek II") by authorizing the City Manager to take actions, as described below, to facilitate the transfer of EmTek II to a Private Nonprofit Financial Intermediary.

Other Recommendations – None

Fiscal Impact – In order to effectively transfer EmTek II to a private nonprofit financial intermediary, the City will need to transfer a \$250,000 Program Reserve Fund (half of which was funded by the City with Industrial Development Bond income and half by the County of San Diego under a Memorandum of Understanding dated December 9, 1997) to the Jacobs Center for Nonprofit Innovation ("JCNI"). The City Manager recommends that the City funded portion of the Program Reserve (\$125,000) be transferred to JCNI and that the County funded portion (\$125,000) be similarly transferred once the City has had the opportunity to renegotiate the Memorandum of Understanding with the County.

EmTek II investor banks have informed the City that it is critical that the \$250,000 Program Reserve Fund be transferred along with all EmTek II assets (loans, cash available to loan and any associated loan warrants) to 1) honor their commitments of capital to EmTek II and 2) to ensure that additional private sector funds will be provided to EmTek II to facilitate the City's long-term capitalization objectives for the fund. This action will have no impact to the City's General Fund.

BACKGROUND

Emerging Technologies Revolving Loan Fund Phase I ("EmTek I") was funded in 1993 via a federal Economic Development Administration defense conversion grant to the City. In 1999, the second capitalization of the EmTek fund (EmTek II) was accomplished through a consortium of local banks, via a \$1.1 million Recoverable Grant/Non-Recourse Note through JCNI and included a \$250,000 Program Reserve Fund jointly funded by the City and County.

The City Council's long-term vision as expressed in the EmTek Phase II Program Plan approved in 1999 (R-291535) when it received JCNI's Recoverable Grant/Non-Recourse Note was to grow EmTek to the level where the program could be self-supporting, then privatize EmTek as a stand-alone or merged nonprofit financial intermediary.

DISCUSSION

The \$1.1 million EmTek II revolving loan fund currently has 5 outstanding loans totaling \$799,058 and \$300,942 in funds available to loan. EmTek II provides participating working capital loans to promising smaller early-stage growth ventures. Program income associated with the EmTek II program approximately covers the expense of one managing staff position within the Business Finance section of the Economic Development Division; however, limited General Fund resources in FY 05 resulted in the elimination of one of four key positions charged with managing EmTek II and three other City revolving loan programs within the Economic Development Division.

EmTek II investor banks have expressed concern over the elimination of the fund manager position in FY 05 and have suggested that JCNI be given the opportunity/responsibility to expand the capitalization of EmTek II by receiving its assets (loans, cash available to loan and any associated loan warrants) and partnering with an appropriate private nonprofit intermediary. JCNI representatives and the Board of Directors for the California Southern Small Business Development Corporation ("CSSBDC") have recently indicated interest in facilitating the continued growth of EmTek II by assuming responsibility to serve as the needed private nonprofit financial intermediaries.

Precedents for transferring public lending programs to private financial intermediaries include:

- San Diego CDC Small Business Finance Corporation, which was launched with

Community Development Block Grant funds as an Urban League program and is now the nation's largest Small Business Administration 504 Program lender.

- The Utah Technology Finance Corporation, a privatized venture lender similar to EmTek II that began as a state loan program and subsequently raised \$10 million from several bank investors, including EmTek II investor banks (Washington Mutual, Wells Fargo Bank, California Bank & Trust parent bank, Zion's Bancorp).

In order to: 1) address the concerns of EmTek II investor banks, 2) respond to the expressed interest from JCNI / CSSBDC and 3) follow the City Council's original intent as expressed in the EmTek Phase II Program Plan approved in 1999, it is recommended that the City Manager be authorized to proceed with the following actions:

- 1) Request that JCNI formally request of the City that the Recoverable Grant Agreement and Non-Recourse Note approved by Ordinance No. O-18797 adopted on May 1, 2000 be terminated and that all EmTek II assets (loans, cash available to loan and any associated loan warrants) be transferred back to JCNI so that they can in turn execute a new fund management agreement with CSSBDC or another appropriate private nonprofit financial intermediary.
- 2) Securing formal approval of the above referenced JCNI transfer request from EmTek II investor banks.
- 3) Upon completion of 1) and 2) above, facilitate the transfer of all EmTek II assets (loans, cash available to loan and any associated loan warrants) and \$125,000 of the Program Reserve Fund to JCNI.
- 4) Renegotiate the MOU with County dated December 9, 1997, which discusses EmTek Loan Program responsibilities and funding, to reflect the transfer of EmTek II assets and responsibilities.

CONCLUSION

The City has successfully developed the EmTek II revolving loan program to provide needed capital to promising smaller early-stage growth ventures. In order to most fully achieve its mission of addressing the unmet capital needs of small businesses, the Program Plan for EmTek II contemplated the eventual privatization of the revolving loan fund to increase its capitalization and effectiveness. Given limited City budget/staffing resources, privatization suggestions from EmTek II investor banks, and program management interest from credible private nonprofit financial intermediaries, it is recommended that the City act to privatize EmTek II at this time. By authorizing the City Manager to proceed with the above referenced actions, the City creates the best opportunity for EmTek II going forward and can be proud of its lending/employment accomplishments to date with this revolving loan fund program.

Respectfully submitted,

Hank Cunningham
Community & Economic Development Director

Approved: Bruce Herring
Deputy City Manager

CUNNINGHAM/JK